Supreme Court, U.S.

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IN THE

Supreme Court of the United States

HAGGAR APPAREL CO.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether 19 C.F.R. § 10.16(c) reasonably interprets the statutory phrase "operations incidental to the assembly process" in Subheading 9802.00.80 of the Harmonized Tariff Schedule of the United States.

PARTIES TO THE PROCEEDING AND RULE 29.6 DISCLOSURE STATEMENT

The only parties to the proceeding are the petitioner and respondent as listed in the caption. Petitioner Haggar Apparel Company is now known as Haggar Clothing Company. Petitioner's parent company is Haggar Corporation. No other publicly held company owns 10% or more of petitioner's stock.

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OPINIONS BELOW

The July 27, 2000, opinion of the Court of Appeals for the Federal Circuit, following remand from this Court, is reported at 222 F.3d 1337. See Appendix ("App.") 1a-12a. The July 12, 1996, opinion of the Court of International Trade (App. 13a-28a) is reported at 938 F. Supp. 868. The October 22, 1997, opinion of the Federal Circuit (App. 29a-32a) is reported at 127 F.3d 1460.

JURISDICTION

Haggar Apparel Company's petition for rehearing was denied on October 19, 2000. App. 33a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

1. Subheading 9802.00.80 of the Harmonized Tariff Schedule of the United States, 19 U.S.C. § 1202, provides that, with respect to:

> Articles . . . assembled abroad in whole or in part of fabricated components, the product of the United States, which (a) were exported in condition ready for assembly without further fabrication, (b) have not lost their physical identity in such articles by change in form, shape or otherwise, and (c) have not been advanced in value or improved in condition abroad except by being assembled and except by operations incidental to the assembly process such as cleaning, lubricating and painting[, the duty that is to be paid is to be calculated] upon the full value of the imported article, less the cost or value of such products of the United States . . . .

2. Subsections (b) and (c) of 19 C.F.R. § 10.16 provide as follows:

> (b) Operations incidental to the assembly process. Operations incidental to the assembly process whether performed before, during, or after assembly, do not constitute further fabrication, and shall not preclude the application of the exemption. The following are examples of operations which are incidental to the assembly process:
>
> (1) Cleaning;
>
> (2) Removal of rust, grease, paint, or other preservative coating;
>
> (3) Application of preservative paint or coating, including preservative metallic coating, lubricants, or protective encapsulation;
>
> (4) Trimming, filing, or cutting off of small

amounts of excess materials;

(5) Adjustments in the shape or form of a component to the extent required by the assembly being performed abroad;

(6) Cutting to length of wire, thread, tape, foil, and similar products exported in continuous length; separation by cutting of finished components, such as prestamped integrated circuit lead frames exported in multiple unit strips; and

(7) Final calibration, testing, marking, sorting, pressing, and folding of assembled articles.

(c) Operations not incidental to the assembly process. Any significant process, operation, or treatment other than assembly whose primary purpose is the fabrication, completion, physical or chemical improvement of a component, or which is not related to the assembly process, whether or not it effects a substantial transformation of the article, shall not be regarded as incidental to the assembly and shall preclude the application of the exemption to such article. The following are examples of operations not considered incidental to the assembly as provided under subheading 9802.00.80, Harmonized Tariff Schedule of the United States (19 U.S.C. § 1202):

(1) Melting of exported ingots and pouring of the metal into molds to produce cast metal parts;

(2) Cutting of garment parts according to pattern from exported material;

(3) Painting primarily intended to enhance the appearance of an article or to impart distinctive features or characteristics;

(4) Chemical treatment of components or assembled articles to impart new characteristics, such as

showerproofing, permapressing, sanforizing, dying or bleaching of textiles;

(5) Machining, polishing, burnishing, peening, plating (other than plating incidental to the assembly), embossing, pressing, stamping, extruding, drawing, annealing, tempering, case hardening, and any other operation, treatment or process which imparts significant new characteristics or qualities to the article affected.

STATEMENT OF THE CASE

1. Haggar Apparel Company designs, manufactures, and markets a wide variety of men's apparel products. The apparel products at issue in this case are men's permanent-press trousers, which were assembled in Mexico from fabric manufactured at textile mills in the United States. App. 14a. Permanent-press garments are those that maintain a smooth, wrinkle-free appearance without ironing or pressing, even after they have been washed and worn. *Id.*; J.A. 31.[1] The permanent-press characteristics are achieved in different ways depending on the type of fabric used to make the garments.

For trousers made from a cotton-polyester blend, Haggar had the fabric treated with a chemical resin at textile mills in the United States before shipping the fabric to Mexico for assembly. App. 14a. To achieve permanent-press characteristics, heat must be applied to the fabric. J.A. 33. Thus, after assembly, the completed trousers were pressed and then baked in an oven for 12-15 minutes. App. 14a; J.A. 33. The same permanent-press characteristics could have been achieved without the ovenbaking process, simply by pressing the trousers for an additional two to three minutes. J.A. 57. Haggar found ovenbaking less expensive than

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[1] "J.A." refers to the Joint Appendix filed in *United States* v. *Haggar Apparel Co.*, 526 U.S. 380 (1999) (No. 97-2044), when the case was first before the Court.

further pressing, however, because the ovenbaking process was automated and involved the use of fully depreciated equipment. App. 23a; J.A. 41-42, 57. After ovenbaking, the trousers were tagged, packaged, and shipped back to the United States. App. 15a.

Haggar also made trousers from all-synthetic fabric. Trousers made from the all-synthetic fabric had to be pressed in order to achieve permanent-press characteristics, but the fabric did not require chemical treatment or ovenbaking. App. 14a. Haggar shipped the all-synthetic fabric to Mexico, where the components were assembled and the trousers were then pressed. After pressing, the trousers were tagged, packaged, and shipped back to the United States. See *id.* at 15a.

2. Upon arrival in the United States, Haggar's trousers were subject to customs duties. Ordinarily, a duty would be imposed on the full value of the imported goods. However, the tariff provisions enacted by Congress provide a partial duty exemption for certain goods that are assembled abroad but whose components were made in the United States. As relevant here, Subheading 9802.00.80 of the Harmonized Tariff Schedule of the United States (HTSUS), 19 U.S.C. § 1202, provides that the duty owed on such goods is to be calculated based upon "the full value of the imported article, less the cost or value of [the components made in the United States]," if certain conditions are met. The condition at issue in this case requires that the American-made components sent abroad for assembly not have been "advanced in value or improved in condition abroad except by being assembled and except by operations incidental to the assembly process such as cleaning, lubricating and painting." 19 U.S.C. § 1202, subheading 9802.00.80.[2]

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[2] The HTSUS took effect on January 1, 1989. App. 3a n.1. The text of Item 807.00 of the Tariff Schedule of the United States (TSUS), which applied prior to January 1, 1989, is identical to Subheading 9802.00.80.

The Customs Service has promulgated a regulation interpreting the phrase "operations incidental to the assembly process" as used in Subheading 9802.00.80. The regulation attempts to define those operations that may be classified as incidental and those that may not. See 19 C.F.R. § 10.16. As relevant here, that regulation provides: "Any significant process, operation, or treatment other than assembly whose primary purpose is the . . . physical or chemical improvement of a component . . . shall not be regarded as incidental to the assembly and shall preclude the application of the exemption to such article." *Id.* § 10.16(c). The regulation then provides several examples of operations not deemed incidental to assembly, including the "[c]hemical treatment of components or assembled articles to impart new characteristics, such as showerproofing, permapressing, sanforizing, dying or bleaching of textiles." *Id.* § 10.16(c)(4). The regulation also provides several examples of operations that are considered incidental to assembly, such as "sorting, pressing, and folding of assembled articles." *Id.* § 10.16(b)(7).

3. Haggar sought a partial duty exemption for its permanent-press trousers under Subheading 9802.00.80 of the HTSUS, on the ground that the pressing of the all-synthetic trousers, and the pressing and ovenbaking of the cotton-polyester trousers, were operations incidental to the assembly of the garments. The Customs Service granted the exemption for the all-synthetic trousers, but denied the exemption for the cotton-polyester trousers, despite the fact that the method of producing both types of trousers "involve[d] the same assembly and pressing process." App. 14a. The only difference was that the cotton-polyester trousers were ovenbaked instead of given a more-expensive extended pressing.

Haggar paid the required duties and then brought a refund suit in the Court of International Trade, which has exclusive jurisdiction to review protests of classification determinations by the Customs Service. See 28 U.S.C. § 1581(a). Applying the multi-factor test established in *United States* v. *Mast*

Industries, Inc., 668 F.2d 501 (C.C.P.A. 1981), the court concluded that the ovenbaking operation was incidental to the assembly process and thus did not disqualify Haggar's cotton-polyester trousers from the partial duty exemption under Subheading 9802.00.80. App. 25a.

The government attempted to defend the Customs Service's classification of the goods by relying on 19 C.F.R. § 10.16(c). The court declined to apply the regulation, however, because it concluded that "[s]ubsection 10.16(c) conflicts with the plain language" of Item 807.00 of the TSUS (the predecessor to Subheading 9802.00.80 of the HTSUS). App. 26a. The court noted that Item 807.00 "does not prohibit operations which merely impart new characteristics to the article being assembled as the regulation provides, but in fact permits a duty allowance for such improvements to the article so long as the operation imparting those characteristics was incidental to assembly." *Id.* at 26a-27a (emphasis omitted). Based on Federal Circuit precedent, the court rejected the government's argument that the customs regulation was entitled to deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). App. 27a.

4. The government appealed to the Federal Circuit, which has exclusive jurisdiction to review decisions of the Court of International Trade. See 28 U.S.C. § 1295(a)(5). The Federal Circuit affirmed. App. 29a-32a. The court of appeals agreed with the trial court's application of the *Mast* factors, and held that customs regulations relating to tariff classifications are not entitled to *Chevron* deference. *Id.* at 31a.

5. This Court granted the government's petition for a writ of certiorari. 524 U.S. 981 (1998). The government's petition raised two questions: (1) whether customs regulations relating to tariff classifications are entitled to deference under *Chevron*; and (2) if so, whether 19 C.F.R. § 10.16(c) is a reasonable interpretation of the statutory phrase "operations incidental to the assembly process" under

Subheading 9802.00.80. This Court reversed on the first question, holding that the Federal Circuit erred in declining to apply the *Chevron* framework to tariff classification regulations. *United States* v. *Haggar Apparel Co.*, 526 U.S. 380 (1999).

The Court declined to reach the second question on which certiorari had been granted, leaving to the Federal Circuit on remand the task of determining in the first instance "how the regulation at issue fares under the *Chevron* framework." *Id.* at 395. The Court stated that it found this to be a "difficult question," in light of the "substantial arguments" Haggar had raised "challenging the regulation's interpretation of the statutory language as well as the application of the regulation to the particular process and goods at issue here." *Id.* at 394-95. Specifically, with respect to the application of the regulation, the Court noted that the Customs Service had granted a duty exemption for the all-synthetic trousers yet denied an exemption for the ovenbaked cotton-polyester trousers, "notwithstanding the fact that the permapress characteristics could have been achieved on the trousers involved here by pressing them for an additional period of time in lieu of ovenbaking." *Id.* at 395. In addition, the Court noted that the Customs Service sought to apply the regulation's reference to "[c]hemical treatment of components . . . such as . . . permapressing," 19 C.F.R. § 10.16(c)(4), even though "it is undisputed that the chemical resin was applied to the trousers in the United States." 526 U.S. at 395.

6. On remand, the Federal Circuit held that "19 C.F.R. § 10.16(c) is a reasonable interpretation of HTSUS 9802.00.80 (and TSUS 807.00), and that Customs properly applied the regulation in this case." App. 5a. The court of appeals began its *Chevron* analysis by observing that "the Supreme Court has already answered the first question: HTSUS 9802.00.80 is ambiguous for *Chevron* purposes." *Id.* at 6a. The court thus proceeded directly to the second step of *Chevron*'s analysis. But the court viewed its task as limited

to determining only whether the regulation's interpretation of the statutory phrase "operations incidental to the assembly process" was "contrary to the intent of [c]ongress, as divined from the statute and its legislative history." *Id.* at 6a-7a (internal quotation marks omitted). The court upheld the regulation because, in its view, the categorical approach taken by the Customs Service in defining operations not incidental to assembly was not contrary to congressional intent, and use of that approach inevitably required the drawing of fine lines. *Id.* at 9a. The court did not address any of Haggar's other "substantial arguments" concerning the validity of the regulation or the specific categories applied in this case.

Though this Court had specifically highlighted the issue, the court of appeals also made no effort to determine whether the line Customs had drawn between Haggar's "pressing" and "permapressing" operations was arbitrary and irrational. Nor did the Federal Circuit confront the fact (also highlighted by this Court) that the "chemical treatment" referred to in the regulation actually occurred in the United States. The court of appeals instead noted that the ovenbaking process occurred in Mexico, and that this application of heat "causes the chemical change in the fabric, imparting the 'permapress' qualities." *Id.* at 12a. But the court did not explain how ovenbaking could rationally be distinguished from pressing of the all-synthetic trousers, since both processes occurred in Mexico and imparted "permapress" qualities to the garments. The court's observation that the cotton-polyester trousers "left the United States without permapressed qualities . . . [and] returned permapressed," *id.*, was no answer, because that was equally true of the all-synthetic trousers, for which Customs had provided a partial duty exemption under Subheading 9802.00.80.

REASONS FOR GRANTING THE PETITION

This Court previously granted certiorari on the same question presented here: whether 19 C.F.R. § 10.16(c)

reasonably interprets the statutory phrase "operations incidental to the assembly process." Although the Court did not resolve that issue in *United States* v. *Haggar Apparel Co.*, 526 U.S. 380 (1999), the Court expressly stated that it found this to be a "difficult question." *Id.* at 395. The Court also directed the Federal Circuit to address Haggar's "substantial arguments" regarding the irrationality of Customs' application of this regulation here, and specifically Customs' distinction between "pressing" and "permapressing" operations. *Id.* at 394-95.

The court of appeals failed to conduct either inquiry. Instead, the court simply addressed whether Customs could reasonably have adopted a category-based approach to classifying those processes that are incidental to assembly. Having decided that Customs could regulate on the basis of categories, the Federal Circuit summarily affirmed the Customs decision below. It therefore never reached the specific and difficult questions raised by Customs' arbitrary application of its regulations, for which this Court specifically remanded.

The Federal Circuit's failure to provide any meaningful analysis of the rationality of Customs' exercise of discretion is not limited solely to this case. In a companion case, *Levi Strauss & Company* v. *United States*, 222 F.3d 1344 (Fed. Cir. 2000), petition for cert. filed January 17, 2001, the court failed to consider not only the irrationality of the application of the categorical scheme to the goods at issue, but also whether the particular subcategory at issue could itself be reconciled with the statute. The *Haggar* and *Levi* cases thus confirm that the Federal Circuit has effectively granted the Customs Service unreviewable discretion both to adopt categories that are not incidental to assembly, and to apply those categories at will. The Federal Circuit's failure to review the agency's exercise of discretion conflicts with this Court's mandate in *Haggar*, with *Chevron*, and with the

court's fundamental obligation to review timely challenges to arbitrary agency action.

If left uncorrected, the decision below will have nationwide impact. The Federal Circuit exercises exclusive appellate jurisdiction over customs classification disputes, and thus is the only appellate forum in which challenges to classification regulations may be heard as a matter of right. That court's refusal to require *any* reasoned explanation from Customs for the categorical lines it has drawn will deprive litigants in customs disputes of the ability to seek redress for arbitrary agency action. Indeed, now that the Federal Circuit turns a deaf ear to questions that this Court has declared are substantial, future litigants have no realistic hope of getting the Federal Circuit to address their comparable claims. The petition should therefore be granted in light of the exceptional importance of the issue raised and the manifest error of the Federal Circuit's holding.

1. In remanding for further proceedings, this Court confirmed that Haggar had raised substantial questions concerning the validity of the agency's interpretation of the statutory language and of its application of the regulation to the goods at issue here. 526 U.S. at 394-95. The lower court's failure to address these questions on remand reflects not only its misreading of the Court's decision in *Haggar*, but an equally fundamental misperception of its crucial obligation to conduct arbitrariness review under step two of *Chevron*.

The two-step test this Court established in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), has become a familiar part of American administrative law. Under the first step, courts must determine whether "Congress has directly spoken to the precise question at issue." *Id.* at 842. If so, the court "must give effect to the unambiguously expressed intent of Congress," *id.* at 843, by rejecting any administrative interpretation of the statute that is contrary to that intent, *id.* at 843 n.9. However, if the statute "is silent or ambiguous with respect to the specific issue," the

court must proceed to the second step, which requires the court to determine "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843. Subsequent cases have made clear that "permissible" in this context is synonymous with "reasonable." See, *e.g.*, *National Credit Union Admin.* v. *First Nat'l Bank & Trust Co.*, 522 U.S. 479, 500 (1998); *Pauley* v. *Bethenergy Mines, Inc.*, 501 U.S. 680, 699 (1991).

The Court's cases have not explicitly defined the circumstances under which an agency's interpretation of a statute, although not contrary to clear congressional intent, may nonetheless be deemed unreasonable. See Ronald M. Levin, *The Anatomy of* Chevron: *Step Two Reconsidered*, 72 Chi.-Kent L. Rev. 1253, 1261 (1997) (noting that the Court has never invalidated an agency's interpretation of a statute under step two of *Chevron*). But the Court provided some guidance on this score in *Chevron* itself. There, the Court stated that when agencies issue regulations to fill gaps left in the statutory scheme, such regulations "are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." 467 U.S. at 843-44. Directing courts to engage in arbitrary-and-capricious review under step two was in line with the Court's pre-*Chevron* cases. In *Schweiker* v. *Gray Panthers*, 453 U.S. 34 (1981), for example, the Court held that, when Congress has delegated authority to an agency to interpret statutory terms, a court may not "abdicate review"; rather, the court must ensure that the agency did not exceed its authority and that "the regulation is not arbitrary or capricious." *Id.* at 44. In post-*Chevron* cases, as well, the Court has indicated that determining whether an agency's interpretation is "reasonable" requires an assessment of whether that interpretation is arbitrary or capricious. See, *e.g.*, *United States* v. *O'Hagan*, 521 U.S. 642, 673 (1997); *Smiley* v. *Citibank (S.D.), N.A.*, 517 U.S. 735, 741-42 (1996).

The court of appeals clearly departed from established law by failing to engage in any arbitrariness analysis below. As

noted above, the Federal Circuit conceived of its role under *Chevron*'s second step as determining only whether the regulation "was contrary to the intent of [c]ongress." App. 7a (internal quotation marks omitted). That limited review, however, was only half of the equation. Before pronouncing the agency's interpretation of the tariff statute reasonable, the court of appeals was also obligated to assess whether, within those broad parameters, Customs had rationally exercised its discretion to interpret the statute. See *NLRB* v. *United Food and Commercial Workers Union*, 484 U.S. 112, 123 (1987). And where, as here, that issue was in doubt, the agency was required to provide a "satisfactory explanation" for drawing the lines as it did. See *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983). The court below, however, made no attempt to determine whether the agency's interpretation of Subheading 9802.00.80 was arbitrary or capricious under these standards.

As a result, the Federal Circuit never addressed this Court's specific concerns regarding the rationality of Customs' interpretation of the statutory phrase "operations incidental to the assembly process." For example, the court of appeals failed to require any explanation from Customs for the agency's decision to treat Haggar's pressing of the all-synthetic trousers differently from the ovenbaking of the cotton-polyester trousers, even though both processes were used to impart the same permanent-press characteristics to the garments. The rationality of that distinction was particularly suspect since, as the Court noted, "the permapress characteristics could have been achieved on the trousers involved here by pressing them for an additional period of time in lieu of ovenbaking." *Haggar*, 526 U.S. at 395. Nor did the court of appeals require Customs to address the Court's concern that, although the agency's regulation referred to the "[c]hemical treatment of components" abroad, see 19 C.F.R. § 10.16(c)(4), Customs applied the regulation in this case even though "it is undisputed that the chemical resin

was applied to the trousers in the United States," *Haggar*, 526 U.S. at 395. By failing to address these issues, the court of appeals left Haggar, as well as importers in future cases, at the mercy of Customs' arbitrary interpretation of important tariff provisions.[3]

This case thus raises serious separation of powers concerns. As this Court established in *Marbury* v. *Madison*, 5 U.S. (1 Cranch) 137 (1803), "[i]t is emphatically the province and duty of the judicial department to say what the law is." *Id.* at 177. Mandating deference to an agency's interpretation of the law, as *Chevron* requires, is in considerable tension with this principle. An acceptable balance has been struck under *Chevron* only because courts must still review the rationality of an agency's construction of a statute, and ensure that the agency's construction is consistent with congressional intent. The Federal Circuit has upset that balance, however, by granting the Customs Service free rein to define governing law, without regard to the constraints imposed by Congress and without any meaningful review by the courts.

The Federal Circuit's failure to engage in any form of arbitrariness review under *Chevron*'s second step is in conflict with the approach followed in a majority of the circuits. See *Strickland* v. *Commissioner, Maine Dep't of Human Servs.*, 96 F.3d 542, 547 (1st Cir. 1996); *Velazquez* v. *Legal Servs. Corp.*, 164 F.3d 757, 763 (2d Cir. 1999); *Chang* v. *INS*, 119 F.3d 1055, 1060 (3d Cir. 1997); *In re Kaiser*

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[3] The Federal Circuit's failure to scrutinize the rationality of customs regulations is not an isolated occurrence. In *Levi Strauss*, the court engaged in no analysis at all of the regulation's consistency with the statute or its application to the specific stonewashing process at issue there. Similarly, in another post-*Haggar* case, the court failed properly to engage in analysis under *Chevron*'s second step and upheld a regulation that defined the statutory terms "journey" and "originated" in a manner that produced wholly irrational results. See *Princess Cruises, Inc.* v. *United States*, 201 F.3d 1352, 1361 (Fed. Cir.), *cert. denied*, 120 S. Ct. 2741 (2000).

Aluminum & Chem. Co., 214 F.3d 586, 591 (5th Cir. 2000); *Iowa Util. Bd.* v. *FCC*, 219 F.3d 744, 749 (8th Cir. 2000); *Zimmerman* v. *Oregon Dep't of Justice*, 170 F.3d 1169, 1173 (9th Cir. 1999); *Pharmanex* v. *Shalala*, 221 F.3d 1151, 1154 (10th Cir. 2000); *Cook* v. *Wiley*, 208 F.3d 1314, 1319 (11th Cir. 2000). These courts have expressly stated that, in order to be found reasonable under *Chevron*'s second step, an agency's interpretation of a statute must withstand review under an arbitrary-and-capricious standard. The District of Columbia Circuit is substantially in accord. See, *e.g.*, *American Petroleum Inst.* v. *EPA*, 216 F.3d 50, 57 (D.C. Cir. 2000) (noting overlap between *Chevron*'s second step and arbitrary-and-capricious review); *National Ass'n of Regulatory Util. Comm'rs* v. *ICC*, 41 F.3d 721, 726-27 (D.C. Cir. 1994) (same). See also Kenneth C. Davis & Richard J. Pierce, Administrative Law Treatise § 7.4, at 264 (3d ed. Supp. 2000) (noting "complete overlap" between the analysis required under step two of *Chevron* and arbitrary-and-capricious review under *State Farm*). While the law on this point is not as clear in the Fourth, Sixth, and Seventh Circuits, the Federal Circuit appears to stand alone in its disregard of fundamental *Chevron* principles for step two.

This case is without question the appropriate vehicle for the Court to address the Federal Circuit's failure to apply *Chevron* properly to Customs' decisions. If the Federal Circuit has not applied the correct standard here, where this Court itself pointed out the difficult questions to be confronted, it certainly will not apply the correct analysis under step two of *Chevron* in subsequent cases where a mere litigant raises comparable issues. Unless this Court intervenes now, the decision below will stand as the leading case in the Federal Circuit on the application of *Chevron*'s framework to customs regulations. And given the court's deficient analysis in the companion case below, *Levi Strauss & Co.* v. *United States*, 222 F.3d 1344 (Fed. Cir. 2000), as well as its earlier decision in *Princess Cruises, Inc.* v. *United*

States, 201 F.3d 1352 (Fed. Cir. 2000), see n.3 *supra*, there is no reason to believe the Federal Circuit will correct this error itself.

The Court should grant certiorari here to clarify that the reasonableness test under *Chevron*'s second step requires courts to examine whether an agency has exercised its discretion to interpret a statute in an arbitrary or capricious manner, and to make clear that agencies must adhere to standards of rationality when they interpret statutes no less than when they engage in purely policymaking functions.

2. Despite this Court's express directive that the Federal Circuit consider the "substantial arguments" Haggar had raised "challenging the regulation's interpretation of the statutory language," 526 U.S. at 394, the Federal Circuit simply left most of them unaddressed. It thus failed correctly to resolve the one aspect of step-two analysis that it did undertake: determining whether the Customs Service's regulation was contrary to congressional intent.

Section 10.16 sets forth a general definition of the statutory concept of operations "incidental to assembly," and identifies two types of non-incidental operations: those whose "primary purpose is the fabrication, completion, physical or chemical improvement of a component," and those that are "not related to the assembly process." 19 C.F.R. § 10.16(c). The regulation then lists several specific operations that are deemed not to be incidental to assembly under the regulation, and identifies "[c]hemical treatment of components or assembled articles to impart new characteristics, such as . . . permapressing" as one such operation. *Id.* § 10.16(c)(4). This regulation plainly conflicts with congressional intent for three reasons.

First, in addressing the only argument that it did confront relating to congressional intent, the Federal Circuit erred in holding that the statute permits the Customs Service to identify, in advance, certain operations that intrinsically are

"not incidental to assembly," no matter what the facts surrounding a particular assembly process or incidental operation may be. That is not the inquiry that Congress commanded. The statute asks not that an operation be compared to "assembly" in the abstract, but that it be compared to "*the* assembly *process*." 19 U.S.C. § 1202, subheading 9802.00.80 (emphasis added). Because each article has its own assembly process, this language can meaningfully be read to refer *only* to the specific assembly process used to create the article whose duty is in question. That the statute requires a comparative inquiry into the significance of a given operation in light of a particular assembly process, and not a classification ex ante, is further evidenced by the plain meaning of the term "incidental," which compels a comparative inquiry. See, *e.g.*, *Black's Law Dictionary* 762 (6th ed. 1990) (defining "incidental" as "[d]epending upon or appertaining to something else as primary"). Given this language, the processes that Congress identified in the statute can reasonably be understood only as examples likely to be incidental to any assembly process, not as a license to ignore the comparative inquiry otherwise mandated by the statutory language.

Second, even if the Customs Service could permissibly adopt a categorical approach in defining operations not considered incidental to assembly, the agency erred by using criteria for classifying permapressing operations that conflict with the statute. Thus, the regulation classifies as non-incidental those operations whose "primary purpose is the . . . chemical improvement" of a component. 19 C.F.R. § 10.16(c). The "primary purpose" criterion sweeps far too broadly, however, because – by definition – *any* operation that is not intended to assemble an article (and hence is not part of the assembly process) will have as its "primary purpose" some object other than assembly. Yet the statute plainly reveals that Congress intended to allow a duty

allowance so long as the operation, though not part of the assembly process, was incidental to it.

Third, the classification itself is also impermissible because it excludes from consideration operations whose primary purpose is the "chemical improvement" of a component of the article. Subheading 9802.00.80 of the HTSUS, however, permits a duty allowance for American-made products assembled abroad that "have not been advanced in value or improved in condition abroad except by being assembled and except by operations incidental to the assembly process such as cleaning, lubricating and painting." These words plainly indicate that operations which do, in fact, advance the value of a product or improve its condition do not, for that reason alone, preclude an allowance. Rather, the ultimate question is whether such improvement came about through operations that are incidental to the assembly process. As the Federal Circuit had previously recognized, "item 807.00 logically assumes that there has been an advancement or improvement, but limits the extent of the advancement in value or improvement in condition to that which is brought about solely by the act of assembly or operations incidental thereto." *Miles* v. *United States*, 567 F.2d 979, 983 (C.C.P.A. 1978).

The examples in subsection 10.16(c)(4) of operations whose primary purpose is the "chemical improvement" of an article are thus impermissible. To impart new characteristics through chemical treatment is simply one way to improve the condition or advance the value of an article. Thus, to identify an operation, such as permapressing, that imparts new characteristics barely begins the statutory inquiry; it does not say anything about whether that operation was "incidental to the assembly process." Moreover, the Customs Service has provided no explanation -- because the court of appeals never required one -- of what separates the improvements listed in subsection (c)(4) from those that are allowed.

What the Customs Service meant by the other general criterion for classifying non-incidental processes – those which are "not related to the assembly process," 19 C.F.R. § 10.16(c) – is not clear. But that criterion provides no additional support for the permapressing regulation. The only factor mentioned in the regulations that would distinguish "permapressing" from "pressing" (which is related to assembly under the regulations) is that permapressing involves a "[c]hemical treatment" that is intended "to impart new characteristics," *id.* § 10.16(c)(4), and thus has as its "primary purpose" the "chemical improvement" of the article, *id.* § 10.16(c). Thus, at least for "permapressing," the regulation's second, general criterion collapses into the first, plainly invalid criterion.

3. Finally, had the court of appeals addressed the difficult issues identified by this Court with respect to the application of these regulations to Haggar's goods, it could not have affirmed the agency's decision. As this Court previously noted, the real issue here is not "permapressing," as specified in the regulation, because the most significant step in the permapressing process – chemical treatment – occurred in the United States. App. 14a; J.A. 37-38. The only permapressing step that occurred abroad was curing – the application of heat through pressing and ovenbaking. But it is clear that curing alone is not enough to make the permapressing regulation applicable, because it is undisputed both that Customs granted a duty allowance on Haggar's all-synthetic trousers, and that these pants were cured by the pressing done abroad. J.A. 33. If curing the all-synthetic trousers is an operation incidental to assembly, then curing the cotton-polyester trousers should be so, too.

If there is any issue here, then, it is whether the use of ovenbaking in addition to pressing meaningfully distinguishes the curing operation used for cotton-polyester fabric from the pressing operation used to cure all-synthetic fabric. Any attempt to analogize "ovenbaking" to the "chemical treat-

ments" listed in 19 C.F.R. § 10.16(c)(4), however, would be wholly arbitrary. As noted above, it is plain that Customs does not regard applying heat to fabric in order to impart new characteristics as a "chemical treatment," because it granted a duty allowance for the all-synthetic trousers that were pressed abroad in order to achieve the performance characteristics associated with permanent press.

Indeed, if any regulation speaks to the issue, it is the regulation that specifically identifies "pressing" as an operation incidental to the assembly process. See *id.* § 10.16(b)(7). Under the Customs Service's categorical approach, any pressing operation that occurs after assembly should be deemed incidental. The post-curing operation that begins with pressing and is completed with ovenbaking, however, could be accomplished just as effectively – although more expensively – simply by pressing the pants for two or three extra minutes, and forgoing ovenbaking altogether. J.A. 41-42, 57. Thus, Customs has never explained why it is rational that a more expensive curing process (extended pressing) would automatically be deemed incidental to assembly, but a less expensive curing process (pressing plus ovenbaking) is not – even though each imparts the identical new characteristics and improved condition to the garment. This is precisely the sort of irrational distinction that renders an agency's interpretation of a statute arbitrary and capricious under step two of *Chevron*.

4. The Federal Circuit's decision to immunize from arbitrariness review the Customs Service's selection and application of its regulations has enormous practical importance for implementation of the Nation's tariff laws. The Federal Circuit has exclusive jurisdiction to review decisions of the Court of International Trade, which in turn has exclusive jurisdiction over classification disputes. See 28 U.S.C. §§ 1295(a)(5), 1581(a). The Federal Circuit's rulings on the validity of customs regulations thus have binding effect nationwide. Furthermore, cases involving challenges to

classification regulations will always proceed to step two under *Chevron*'s framework. For in classification cases, Congress has never addressed the "precise question at issue," *Chevron*, 467 U.S. at 842; the precise question is which tariff classification applies to the specific merchandise at issue. As a result, the Federal Circuit will repeatedly be called upon to apply step-two analysis in its role as essentially the sole arbiter of claims that the Customs Service has interpreted tariff classification provisions irrationally. As demonstrated above, however, the Federal Circuit has "abdicated review" of such claims, see *Schweiker*, 453 U.S. at 44, and only this Court can correct that error.

The Federal Circuit's failure to conduct arbitrariness review in this context could have even greater significance depending on the Court's ruling in *United States* v. *Mead Corp.*, No. 99-1434 (U.S. argued Nov. 8, 2000). In *Mead*, the government has argued that *Chevron* deference is owed not only to formal regulations promulgated by the Customs Service, but also to classification rulings issued by the agency in individual cases. According to the government's own estimates, the Customs Service issues more than one thousand such rulings each year. U.S. Brief at 38 n.26, *United States* v. *Mead Corp.*, No. 99-1434 (U.S. filed Feb. 29, 2000). Thus, if the Court accepts the government's argument in *Mead*, the Federal Circuit's misapplication of *Chevron* will effectively leave all importers who are subjected to irrational classification rulings without an appellate forum in which to obtain meaningful review.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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